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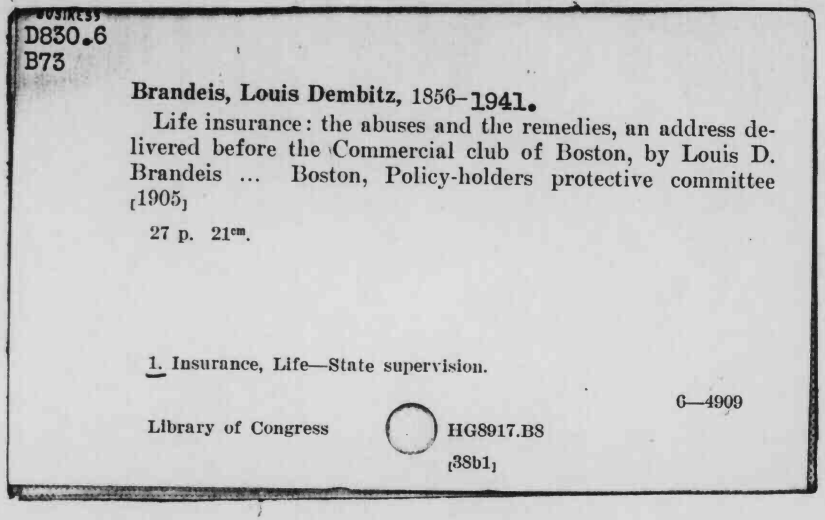
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LIFE INSURANCE: THE ABUSES AND THE REMEDIES

AN ADDRESS
DELIVERED BEFORE THE COMMERCIAL CLUB OF BOSTON

BY

LOUIS D. BRANDEIS

COUNSEL FOR THE PROTECTIVE COMMITTEE OF POLICY-HOLDERS
IN THE
EQUITABLE LIFE ASSURANCE SOCIETY

PUBLISHED BY THE
POLICY-HOLDERS PROTECTIVE COMMITTEE
161 Devonshire St., Boston, Mass.

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LIFE INSURANCE: THE ABUSES AND THE REMEDIES*

MR. PRESIDENT AND GENTLEMEN:

Eight months ago dissension among guilty officers of the Equitable Life Assurance Society first directed public attention to the conduct of the life insurance business. Since then the disclosures of financial depravity have aroused widespread indignation; but even now the importance of the subject is not generally realized.

OUR HUGE LIFE INSURANCE INVESTMENT

On January 1st, 1905, there were outstanding in the ninety principal legal reserve or old line life insurance companies of the United States 21,082,352 policies. By these policies the lives of at least 10,000,000 of our people are insured. As these policies were taken out largely on the lives of husbands, intending to provide for widow and children, it is estimated that, on the average, more than four people are interested in each life insured. So we have in all about 40,000,000 people, or one-half of the total population of the United States, directly interested in the conduct of these ninety companies. The aggregate amount of insurance represented by these 21,082,352 policies was $12,928,493,754. That sum is more than the actual value of all the steam railroads in the United States which on June 30, 1904, was only $11,244,852,000. It is far more than the par value of their aggregate bonds and stocks held by the public, which was only $9,585,467,711.

To provide for that insurance these companies received during the

* Delivered before the Commercial Club of Boston October 26, 1905.

year 1904 new money in the form of premiums aggregating $498,303,279. That is, more than the aggregate interest and dividends paid on all bonds and stocks of our steam railroads held by the public, which, during the year ending June 30, 1904, was only $465,872,674.

On January 1, 1905, these ninety insurance companies held assets aggregating $2,573,186,639. That is, more than three times the aggregate capital of all the 5331 national banks in the United States reporting June 30, 1904, which was only $767,378,148. The assets of these insurance companies were nearly four-fifths as large as the aggregate deposits in all the national banks, which were only $3,312,439,841.

The total income of these insurance companies during the year 1904, including returns from investments, was $612,896,887. That is, more than the total revenue of the United States Government from all sources during the year ending June 30, 1905, which was only $543,423,859.24.

These figures, huge as they are, cover only a part of the direct interest of the American people in life insurance. Besides these ninety legal reserve companies, there are in the United States numberless assessment companies and fraternal beneficiary societies which provide life insurance. Their members are mainly wage-earners who cannot pay the high premiums exacted by the legal reserve companies.

But even the legal reserve companies insure mainly persons of small means, performing essentially the function of the savings bank. The large company advertises with pride its million dollar policies; but in 1904 the average size of the policy in the Equitable was $2,648; in the Mutual Life of New York $2,351; and in the New York Life only $2,076. In the Metropolitan and in the Prudential, which join with the ordinary life insurance business the specialty of insuring working people, the average policy is only $183 and $178, respectively. It will be seen therefore that in spite of the large policies held by a few individuals, the life insurance of this country is in the main held by what we term "the people" — that large class which every system of business and of government should seek to protect.

THE COMPANIES' CONTROL OF QUICK CAPITAL

Such is the direct interest of our people in the proper conduct of the life insurance business — the interest primarily of the home. Indirectly the life insurance business affects our industrial and political life no less vitally and with perhaps even more far-reaching effects. That influence results from the control which the largest life insurance companies exercise over our business and our political institutions by means of the vast accumulation in a few hands of the assets held as insurance reserve, or for deferred dividends or surplus.

The aggregate assets of these ninety legal reserve companies was, on January 1, 1905, $2,573,186,639. Of that sum nearly one-half, or $1,247,331,738, was held by the three leading Wall Street companies, the Mutual Life of New York, the Equitable and the New York Life, not inaptly referred to as "The Big Three" and the "Racers." One billion two hundred and forty-seven million three hundred and thirty-one thousand seven hundred and thirty-eight dollars is a vast sum, but the control exercised by these three companies does not lie mainly in the size of the aggregate assets. It results from their character and from the conditions under which the funds are held. The $1,247,331,738 in assets held by these three Wall Street companies is a trifling amount as compared with the aggregate wealth of the country. What gives to the managers of these and allied insurance companies the control which they exercise over business is the fact that the larger part of the aggregate assets is quick capital. We have in the United States many other great aggregations of assets: in manufacturing, mining and commerce, the Steel Trust, the Oil Trust, the Beef Trust; in transportation, the Northern Pacific-Great Northern combination, the Pennsylvania system and the New York Central system. Even in combinations like these our people recognize a menace to our welfare and our institutions. But between the vast combinations of capital in manufacturing or transportation and the accumulation of capital by the insurance companies there is this marked difference — the capital of the manufacturing, of the mining, and of the railroad companies is, in the main, permanently invested in lands, buildings or machinery, in rails, bridges or equipment, or it is required for operating their properties. The capital of the life insurance companies, on the other hand, is mainly free capi-

tal. The huge manufacturing and transportation companies, great and powerful as they are, are directly dependent for their prosperity upon the prosperity of the country and the service which they render from day to day to the people. Furthermore they are constant borrowers.

The situation of the life insurance companies is entirely different. Except in respect to the growth of their business, they are not dependent for their prosperity upon that of the country. Indeed, they derive certain benefits in times of adversity. While the securities they already hold are not of a class to be imperilled, they can purchase new securities to better advantage. They are the creditors of our great industries, with all the power which that implies.

Of the aggregate capital of these three leading life insurance companies there is invested in real estate only 6.8 per cent. The balance of their assets is substantially quick capital. The larger part of it is invested in bonds and stocks, in collateral loans and money in bank. Moreover, these three companies—the Equitable, the Mutual Life and the New York Life—have in important respects co-operated with each other.

OTHER QUICK CAPITAL INSIGNIFICANT

Compared with their quick capital, that of the great banking institutions of the country is insignificant. The three greatest New York banks—the National City, the Bank of Commerce and the First National—had on September 30, 1905, in capital and surplus, together, only $106,264,800. They had, it is true, in deposits $421,521,900, an aggregate about as large as the assets of a single one of these three insurance companies.

But over their deposits the banks have only a limited control. Twenty-five per cent must always be held as a reserve. Besides, substantially all deposits in banks and trust companies are subject to check. This right of the depositor to call for his money places a great restraint upon the use which it is possible for bank managers to make of the funds under their control; and these insurance companies are probably the largest depositors. On September 30, 1904, these three insurance companies had deposited in banks

and trust companies $77,132,878. Such huge deposits secure to the insurance companies an effectual control over the banking institutions aside from the actual control which they hold through ownership of bank and trust company stocks.

The assets of the life insurance companies are substantially in the absolute control of the managers. Their officers know (except as to new business) with mathematical certainty approximately how much money they will be required to pay out each month for years to come; because the whole insurance business rests upon stability in average death rates. The insurance company may use its capital without danger of its being called by those for whom it is held.

Furthermore, the amount of withdrawals from the banks from time to time is substantially equal to the deposits; whereas the funds of these insurance companies are increasing at an alarming rate. To these three companies alone there was actually paid in premiums and income from investment in the year 1904, $254,870,441.37. Only $111,161,905.25, or 43.61 per cent, was paid out by them to the policy-holders. The balance (except $7,000) was used either for expense or accumulated for the future. In the four years preceding January 1, 1905, the gross assets held by these three companies increased $353,638,734.

The power of the financiers who control these Wall Street companies is further increased by close alliance with other life insurance companies. The largest of these allied companies—the Metropolitan and the Prudential, on January 1st, 1905, had assets aggregating $216,659,984, and their rate of accumulation is even greater than that of the three leaders; for the Metropolitan and the Prudential draw from a larger public, mainly from the workingmen. In five years the assets of these two companies have more than doubled.

The "Big Three," with their lesser but powerful allies, join together in syndicates to insure the financing of the great manufacturing and railroad combinations and furnish the weapons for our Napoleons of finance. The Northern Securities Trust, Morgan's attempt to perfect a monopoly of the railroads in the Northwest; The International Mercantile Marine, Morgan's attempt to monopolize a large part of the shipping of the world; Harriman's and

Gould's ambitious plans—are made possible largely by the gathering of the savings of the people in the treasuries of these five insurance companies. How this financial community of interests operates in even the routine business of the companies may be seen from this: The Equitable held on January 1, 1905, besides $11,190,006 Government, State, City and County bonds and $3,708,945 Russian railroad securities (owned chiefly to comply with the requirements of foreign governments) bonds and stock of the aggregate cost of $192,849,290. Of these securities $184,740,473—that is, all but $8,108,817 (or 4 per cent.) were of corporations in which either one or more of the directors of the Equitable were interested as directors or which were parts of systems controlled by such corporations.

When such facts are considered, it becomes obvious why the financiers who control these great insurance companies with their huge quick capital exercise a predominating influence upon the business of the country. The economic menace of past ages was the church—the dead hand, which gradually acquired a large part of all available lands. The greatest economic menace of to-day is a very live hand—these great insurance companies which are controlling so large a part of our quick capital.

HOW POWER ENTRUSTED HAS BEEN ABUSED

Such is the power which the American people have entrusted to the managers of these large companies. How has it been exercised? Substantially as all irresponsible power since the beginning of the world: selfishly, dishonestly and in the long run inefficiently. The breaches of trust committed or permitted by men of high financial reputation, the disclosure of the payment of exorbitant salaries and commissions, the illegal participation in syndicate profits, the persistent perversion of sacred trust funds to political purposes, the co-operation of the large New York companies to control the legislatures of the country, these disclosures are indeed distressing; but the practice of deliberate and persistent deception of the public which the testimony discloses, though less dramatic, is even more serious. Talleyrand said, "Language was made to conceal thought." George W. Perkins would teach us that "Book-keeping was made to conceal facts." Consider for a moment his situation. An important member of the most famous banking firm in America, and next to the Rothschilds the most famous in the world, confesses this:

The New York Life company, of which he is the vice-president, held on December 31, 1903, an investment taken through his firm, J. P. Morgan & Co., of $4,000,000 in bonds of the International Mercantile Marine. It was a poor investment. It was deemed unwise to make known to the insurance departments and to present and prospective policy-holders the fact that so large an investment in these unfortunate securities was held by his company (and doubtless also how much they had depreciated in market value).

Perkins, the vice president of the New York Life company, and at the same time a member of J. P. Morgan & Co., goes through the form on December 31, 1903, of selling $800,000 of these bonds to his firm at par, and then on January 2, 1904, re-transferring the same to the insurance company at par and interest. This was done in order that the officers of the company might under oath present to the insurance departments of the several States and countries an official statement which would show that the insurance company did not at the close of the year 1903 hold as many of these bonds as was the fact, and that the value of those held was par [which was not the fact].

Again, Perkins confesses that in order to prevent the company's exclusion from Prussia by reason of holding among its investments a large amount of stocks, entries were made in the books of account showing a sale of these stocks. The fact is that the stocks were not actually sold but that their ownership was concealed; and that in order to account on the books for the proceeds of this fake sale, two minor employees of the company — one of them a colored messenger with a salary of $600 per year — were made to give their notes for $3,357,000 with the stock as collateral — and the notes were then represented among the assets. The original purpose of this elaborate system of fraud may have been merely to deceive the Prussian Government; but with a degree of thrift rare in the management of these companies, it was used also to deceive our own insurance commissioners and the policyholders. The New York Life had the effrontery up to the time of Perkins's examination, to declare in extensive advertising that it held no stocks whatever.

In the case of common criminals flight is accepted as confession of guilt. With financiers and business men falsification of books has hitherto been considered the strongest evidence of guilt. Yet the falsification of the books of these companies has been a persistent practice. Secret ledgers have been opened in which were entered questionable investments and more questionable expenditures. Hundreds of thousands spent "for legislative purposes" were charged up in real estate accounts. So elaborate has been the system of fraudulent entries that after months of investigation the particular form of rascality embodied in the Equitable's $685,000 Mercantile Trust Company, so-called "yellow-dog," account has not yet been detected.

The degree of guilt involved in such transactions will be appreciated only when one remembers that the life insurance business beyond all other in the world rests upon confidence — confidence that in the remote, indefinite future the present sacrifice of the policyholder will bring protection to widow and children.

GROSS INEFFICIENCY IN MANAGEMENT

But the management of these companies has been not only selfish and dishonest; it has also been singularly inefficient; and it is by this inefficiency that the policy-holders have actually suffered most. The losses of policy-holders through exorbitant salaries and syndicate operations, though large in the aggregate, are small as compared with the loss from bad management. The test of success in the life insurance business is of course to furnish insurance of absolute safety at the minimum cost. The size of a life insurance company is no evidence of success. It is evidence of energy; it is evidence of business skill; but the writing by the Mutual Life of $1,578,931,833 of insurance and the control of $442,061,529 in assets is, in itself, no more evidence of success as an insurance company than the display of a $12,000 rug in the office of its president. In life insurance, success is proved by a small pro rata expense account, a large percentage of return upon absolutely safe investments, and a small per cent of lapsed and surrendered policies.

Now what is the record of the three largest life insurance companies of the world in this respect? Exclusive of taxes and fees, the per-

centage of expense to total premium income for 1904 was this:

New York Life, 22.73%.
Equitable, 22.78%.
Mutual Life, 24.65%.

These expense percentages are appalling; and yet the companies which besides issuing ordinary life policies make a specialty of insuring the workingmen show an even greater percentage of expense to all premium receipts, namely:

Metropolitan Life, 37.09%.
Prudential, 37.28%.

This Prudential Company which advertises itself as the Rock of Gibraltar, takes for its officers and other management expenses on the average of all business 37.28 cents for every dollar which the policy-holders deposit with it. On the industrial business, the workingman's insurance, the percentage taken is much larger. In addition, the company pays to stockholders in dividends each year an equivalent of 219.78% on the cash paid into the company on the capital stock.

SAVINGS BANKS BY CONTRAST

Compare these huge life insurance companies' charges for managing savings with the cost of running the Massachusetts savings banks. There are in Massachusetts 188 savings banks under the management of probably about 3000 different individuals acting as trustees without compensation. At the close of the financial year, October 31, 1904, these banks held assets aggregating $674,644,990.17, more than half the aggregate held by the three largest life insurance companies of the world. There had been deposited in these 188 savings banks during the year ending October 31, 1904, $105,466,148.68, an amount exceeding half the aggregate of the year's premiums of these three companies ($206,132,511.44). The aggregate expense of taking care of the business of these 188 savings banks for the year 1904 was $1,546,904.44, or less than one-thirtieth of the aggregate expense of these three insurance companies ($48,106,809.00) for the year.

To manage the 188 Massachusetts savings banks cost 23-100 of

one per cent. of the average assets held during the year, or but 1.46 per cent. of the year's deposits. To manage the three large life insurance companies cost 4.03 per cent. of their aggregate average assets and 23.33 per cent. of the year's premium income. That is, the pro rata cost of taking care of the savings invested in these three insurance companies was *seventeen times* as great as the expense of caring for savings invested in our 188 savings banks.

Compare now the service rendered by these two classes of savings institutions. The high priced insurance managers with their banking and trust company adjuncts and high finance directorates earned for their three companies during the year 1904 the following gross return on investments:

New York Life - - - - -	4.14 per cent.
Equitable - - - - - -	4.22 "
Mutual Life - - - - - -	4.24 "
Average - - - - - -	4.20 "

The faithful treasurers of the 188 modest Massachusetts savings banks, supervised mainly by obscure but conscientious citizens, earned during the year ending October 31, 1904, 4.4 per cent. on the average assets. The return earned by our savings banks is thus five per cent. greater than that of the three insurance companies, and a comparison of net returns is even more favorable to the savings banks. I do not say that the income returns of the great companies manned by the great financiers was unreasonably low, but merely that the small banks with their low salaried officers earned more.

LOSS THROUGH LAPSED POLICIES

The average rate of dividends actually paid or credited to the depositors in our savings banks for the year ending October 31, 1904, was 3.75 per cent. with interest compounded semi-annually, and in 1904 no depositor in a Massachusetts savings bank lost a dollar of the principal deposited. On the other hand the practice of the insurance companies in relation to forfeiture and surrender of policies has resulted in a large percentage of the policy-holders losing a great part of all they had paid in premiums.

The whole structure of life insurance rests upon this postulate:

while the duration of life of any individual is uncertain, the average duration of the lives of a large number is certain. You cannot tell how long any one man of say twenty-five years will live, but you can say with certainty that the average age which any thousand men of twenty-five years now living in this country will attain is 63.81 years, and that on the average they will live five years longer than another thousand who are thirty years old. If each of these men wanted $1000 insurance payable at death—the annual premium for each (aside from the expense of management) is that sum, which invested and compounded at the rate which it is assumed the investment will pay (now taken as low as 3 1-2 per cent. or 3 per cent.), will at the end of 38.81 years yield $1000. Now among these 1000 persons the number of deaths increases each year. But under the level premium system practiced by the legal reserve companies, the premium is always the same; that is, in the earlier years the insured pays not only a premium commensurate with the risk of the year, but something on account of the greater risk of future years. For instance, a man at twenty-five pays a premium about twice that which represents the risk of his dying in that year.

Now, a life insurance policy by its terms is usually forfeited unless full premiums are paid for the first three years. Forfeited policies are termed "lapsed" policies. The lapse of a policy results in total loss to the insured of his premium except for the protection temporarily enjoyed. The voluntary surrender of a policy after three full years' premiums are paid results in a loss of part of the premiums paid—because the companies pay on surrender only a fraction of its actual legal reserve value (*e. g.*, in 1904 the Mutual Life paid on surrender only 63.15 per cent. of such value). Experience, especially in these large companies, shows that the mortality of life insurance policies is very much greater than the mortality among policy-holders. The life of an ordinary life policy is short, not because life is short, but because most policies do not come to their natural termination. Thus, in the year 1904 the policies in the Mutual Life which came to a natural termination by death, maturity, or expiry, aggregated only 9,169 in number and $28,278,464 in amount insured; while 7,011 policies, aggregating

$16,896,941 were surrendered, and 33,215 policies, aggregating $74,909,054 lapsed.

Among the companies which make a specialty of insuring workingmen, the mortality of the policies is very much greater. In 1904, 116,894 of the Metropolitan Company's industrial policies terminated by death and expiry; but 1,223,832 terminated by lapse and 61,220 by surrender; that is, only one policy in twelve came to a natural end. In the Prudential Company the condition was even worse. There 82,963 terminated by death and expiry; 945,640 by lapse, and 45,361 by surrender; that is, only one policy in thirteen came to a natural end.

WHY POLICIES LAPSE

People who take out fire insurance policies generally continue the insurance, although a fire policy could be dropped after the term without the insured losing anything, since the insured has had his full protection. But in life insurance, where a large premium is paid in early years on account of the greater mortality of later years, the policy-holder who allows his policy to lapse loses the reserve which had accumulated for him. What is the explanation of this huge mortality in life insurance policies? It can be only this: men are induced to take out life insurance by misrepresentation, or by promises which are not realized; and the extravagant conduct of the business renders the cost of the life insurance so great that the insured cannot continue to carry it.

THE WASTE IN SOLICITING

Consider how great this expense of solicitation is. In the year 1904 the New York Life spent in agents' commissions 11.62 per cent. of all premiums received; the Equitable 11.81 per cent.; the Mutual Life of New York 13.57 per cent.; the Metropolitan 15.01 per cent.; and the Prudential 18.98 per cent. Note that this is the average percentage paid for commissions on all policies, old and new. The percentage on new business is of course much greater. The Mutual Life paid in 1904 for commissions on new business $6,691,016.56 out of premiums aggregating $14,676,651.60, or 45.58 per cent. of the year's premiums on new business. Yet those figures

present only a part of the expense of solicitation. There is, in the next place, all the advertising. For that the Mutual paid in 1904 the greater part of the amount charged to "advertising, printing and postage," which amounts to $1,134,833.76, or 7.73 per cent of the year's premium receipts from new business; and besides this, there is all the office and inspection expense directly entailed by this extensive solicitation. The extent to which solicitation is carried may be inferred from the fact that in the year 1904, the Equitable, the Mutual Life and the New York Life actually wrote 102,314 policies carrying an aggregate insurance of $244,862,421, which were not even taken. That is, the applicant did not pay the first premium. He was brought "to the water" but could not be made "to drink." The aggregate expense of solicitation in these three companies must approximate sixteen per cent of all premium receipts. When it is borne in mind how small a part of the policies come to the natural end of fruition to the policy-holder, and how great consequently is the loss to the policy-holder from lapsed and surrendered policies, the extent of the economic waste resulting from solicitation as practiced will be realized.

SAVING THAT IS LOSING

Life insurance is but a method of saving. The savings banks manage the funds until such time as they shall be demanded by the depositor—the insurance company ordinarily until the depositor's death. The savings bank pays back to the depositor his deposit with interest less the necessary expense of management. The insurance company in theory does the same. The difference is merely that the savings bank undertakes to repay to each individual depositor the whole of his deposit with interest; while the insurance company undertakes to pay to those who do not reach the average age more than they have deposited (including interest) and to those who exceed the average age less than they deposited (including interest).

How many wage-earners would insure in these companies if they were told that for every dollar they pay, forty cents will go to the stockholders', officers' and agents' salaries, or for other running expenses? How many wage-earners would assume the burden of

premiums if they knew that there is but one chance in twelve that they will carry their policies to maturity?

How idle is the boast sometimes made by these companies that they have returned to the policy-holder the whole of his premiums. It is as if the savings bank should boast of returning to the depositor all of his deposit but without any interest. Such practically is what the Equitable, the New York Life and the Mutual Life do to-day. The average expense of the three companies, exclusive of taxes and fees, was 4.03 per cent. of their aggregate assets, while the average of the return of the three companies on investments was 4.2 per cent. It means in plain English that the company takes as compensation for the care of the policy-holder's money, all that that money earns. Such were the terms on which, during the troubled times of the Napoleonic wars, the Duke of Hesse entrusted his money to Meyer Amschel Rothschild, and thus laid the foundation for what, at least until recently, was the world's greatest fortune.

CAUSES OF ABUSES—GENERAL

I have referred specifically to only five of the ninety principal American legal reserve companies, five which are closely allied with Wall Street, which on January 1, 1905, held 56.89 per cent. of the aggregate assets, and which during the year 1904 wrote 67.42 per cent. of all the life insurance written by the ninety companies. Of the remaining eighty-five, some are doubtless managed far less efficiently and quite as dishonestly as any of the leaders; many are, no doubt, managed with scrupulous honesty, and some with reasonable and comparatively great economy; but the methods of conducting the business, particularly of soliciting new business, adopted by the leaders, is to a greater or less extent, and perhaps necessarily, followed by the others at the present time. The existing evils are not to be explained by the presence in office of dishonest or selfish men. The causes which produce these rank abuses are general in their operation. The flagrant dishonesty and selfishness of the

managers of the three leading New York companies are the result, not the cause, of the abuses. Men of character may, for a time, protect other companies in large part from like abuses, but the main cause of the evils disclosed lies in the system, rather than in the men.

It is obvious that the American people whose attention has once been directed to these abuses will not suffer them to continue without some attempt at a remedy. What are the remedies proposed?

FEDERAL SUPERVISION NO REMEDY

The most prominent is Federal supervision. Under the decisions rendered by the Supreme Court of the United States, an act providing for Federal supervision would appear to be clearly unconstitutional. But it is apparently believed that the Supreme Court can be induced to reverse itself. Senator Dryden introduced on February 27, 1905, the bill known as No. 7277, to which attention is invited.

Note the provisions by which this bill seeks to put an end to the intolerable abuses which have been disclosed. An insurance company authorized to do business in the State where organized may, by filing a copy of its charter and a financial statement and depositing $100,000 in securities with the treasurer of the United States, secure a United States license, which will entitle it to do business in any State unless and until the license is revoked by the Federal superintendent for failure to pay a judgment, or because the company is deemed by him unsafe.

The bill omits very many of the provisions which, for instance in Massachusetts, have been inserted for the protection of the policy-holder; it adds not a single one by which he may be better protected.

But even if the Federal law contained all the provisions of the best of the State laws, will the insured gain or lose by substituting the supervision of one man at Washington for the supervision of the several States? Assistant Attorney General Nash of Massachusetts, in his able argument against Federal supervision, has truly said:

"The wisdom, discretion and honesty composite in fifty States and Territories are more to be valued than the excellences of one person appointed at Washington. State supervision is good or bad,

according to the merits of the best of the commissioners. Federal supervision must be good or bad, according to the qualities of one man who is unchecked by the work of co-ordinate officials."

The sole effect of a Federal law would be—the sole purpose of the Dryden bill must have been—to free the companies from the careful scrutiny of the commissioners of some of the States. It seeks to rob the State even of the right to protect its own citizens from the legalized robbery to which present insurance measures subject the citizens, for by the terms of the bill a Federal license would secure the right to do business within the borders of the State, regardless of the State prohibitions, free from the State's protective regulations. With a frankness which is unusual—and an effrontery which is common—among the insurance magnates—this bill is introduced in the Senate by John F. Dryden, the president of the Prudential Life Insurance Company—the company which pays to stockholders annual dividends equivalent to 219.78 per cent. for each dollar paid in on the stock; the company which devotes itself mainly to insuring the working men at an expense of over 37.28 cents on every dollar of premiums paid; the company which, in 1904, made the worst record of lapsed and surrendered industrial policies.

WHY DRYDEN WANTS WHAT HE WANTS

The Prudential Life Insurance Company has a special reason for desiring to avoid State supervision. Three years ago the Massachusetts insurance commissioner insisted that the policy-holders must be protected from the scandalous financial relations between the Prudential Company and its allied Fidelity Trust Company—from schemes as dangerous to the interest of the insured as any laid bare by the investigations of the Equitable, the New York Life and the Mutual Life.

Federal supervision is also advocated by Mr. James M. Beck (formerly Assistant Attorney General of the United States), the counsel for the Mutual Life Insurance Company, and his main argument against State supervision appears to be that the companies pay, in the aggregate, for fees and taxes in the several States $10,000,000, which he says is twice as much as is necessary to cover the expense of proper supervision. Ten million dollars is a large

sum in itself, but a very small one compared with the aggregate assets or the aggregate expense of management. Mr. Beck's company paid in 1904 $1,138,663 in taxes and fees. Its management expenses were $15,517,520, or nearly fourteen times as much. Our Massachusetts savings banks paid in the year ending October 31, 1904, $1,627,794.46 in taxes to this Commonwealth: that is $80,890.02 more than the whole expense of management, which was $1,546,904.44.

Doubtless the insurance departments of some States are subjects for just criticism. In many of the States the department is inefficient, in some doubtless corrupt. But is there anything in our experience of Federal supervision of other departments of business which should lead us to assume that it will be freer from grounds of criticism or on the whole more efficient than the best insurance department of any of the States? For it must be remembered that an efficient supervision by the department of any State will in effect protect all the policy-holders of the company wherever they may reside. Let us remember rather the ineffectiveness for eighteen long years of the Interstate Commerce Commission to deal with railroad abuses, the futile investigation by Commissioner Garfield of the Beef Trust, and the unfinished investigation into the affairs of the Oil Trust in which he has since been engaged. Federal supervision would serve only to centralize still further the power of our Government and to increase still further the powers of the corporations. Supervision alone — whether State or Federal — will not suffice to correct existing abuses in the life insurance business.

FUNDAMENTAL CHANGES NECESSARY

In order to get rid of the abuses, the measures to be applied must be radical and comprehensive. The changes must be fundamental. They are, in my opinion, these:

INSURANCE ONLY A METHOD OF SAVING

First. The recognition of the true nature of the life insurance business: namely, that its sole province is to manage temporarily with absolute safety and at a minimum cost the savings of the people deposited to make appropriate provision in case of death, and

that since its province is mainly to aid persons of small means, it should be conducted as a beneficent, not as a money-making, institution.

DEFERRED DIVIDENDS—THE BLIND POOL

Second. The issuance of deferred dividend policies should be discontinued. The legitimate business of a life insurance company is to insure the life of the individual and to issue life annuities. It should not be used as an investment company or as a means of gambling on the misfortunes of others. The deferred dividend policy with its semi-tontine provision is open to these objections and to others.

The premium in life insurance is ordinarily computed on a higher death rate than actually prevails, and a lower return upon investment than is actually earned. The profits from these and other sources, unless consumed by excessive expenses or accumulated as surplus are commonly payable as dividends to the policy-holder either in cash or in reduction of future premiums. Under the deferred semi-tontine dividend policy the dividends are not paid over annually to each policyholder, but are accumulated for long periods and the accumulated funds distributed, so far as paid out at all, among the surviving policyholders of a particular class.

The dividends thus accumulated form an appreciable part of the huge funds controlled by the companies. Thus of the $442,061,529.16 assets held on January 1, 1905, by the Mutual Life, $71,539,311.70 consisted of what is called "contingent guaranty fund" and what is really deferred dividends. Of the $412,438,381 of the assets of the Equitable, it held $63,800,000, which it included under the term "surplus" but which was in fact deferred dividends. The retention of these funds increases unnecessarily the control of quick capital incident to a large business. It promotes also other evils. It tends to extravagance and inefficient management because it removes the protection which flows from the annual accounting. The annual dividend, the best practical test of the efficiency of the management, is thereby denied to the policy-holders.

The managers control as a "blind pool" this huge fund not

required as an insurance reserve. They may with impunity and without discovery make inroads upon it to cover up extravagance, dishonesty, or the results of inefficient management.

LAVISH COMMISSIONS AND ADVERTISING DEVICES

Third. Lavish payments for solicitors' and agents' commissions and for advertising devices should be discontinued. Such practices, common among the promoters of mining enterprises and of patents, have no place in the business of life insurance. Savings banks have no solicitors. The life insuring habit is well established. The three million people in Massachusetts hold in the thirty-three legal reserve companies doing business in the Commonwealth 1,337,795 life insurance policies, and have only 1,766,614 deposit accounts in our savings banks. The people of the whole United States hold one such policy for every four persons. Undoubtedly many a man has been led by the solicitor's persistence and eloquence to make a thrifty provision for his family. No doubt also the savings bank deposits would be swelled by similar exhortation. But can such missionary work be justified at an expense of twelve to twenty per cent of all premiums paid, when the record of lapsed policies shows that the conversion to that thrift is but temporary? In the year 1903 the Metropolitan wrote 1,788,828 industrial policies; in the year 1904 1,223,832 of its industrial policies lapsed. In the year 1903 the Prudential Company wrote 1,468,230 industrial policies; in the year 1904, 945,640 of its industrial policies lapsed. No one should be induced to take out a policy when the burden is greater than he can carry, or if for other reasons it is not for his interest to do so. The intelligent agent with the knowledge and a recognition of the proper function of the life insurance business, and receiving a modest compensation, has still an economic justification. Many men need the impetus to thrift, since wisdom often lags far in the rear of intelligence; but as the business is now conducted, money paid by the insured as a result of solicitation is in the main wasted. The existing abuse is not that the solicitor earns too much, but that his occupation as pursued is economically unjustified.

NO FORFEITURE OF POLICIES

Fourth. The forfeiture of policies should be prohibited. Under

the level premium system everyone pays each year more than is required for the protection of the single year. He pays something on account of future years. That something ought in every case to be preserved for the insured. The excuse offered by the companies for lapsing is the great initial expense of writing insurance, and that arises mainly from the extravagant commissions paid to agents and for lavish advertising. With the suggested change of method in soliciting, no extraordinary expense would be involved in writing insurance except the fee for medical examination, and that should be paid by the applicant as an initiation fee. The insured should know when he enters upon the investment what the initial cost is.

STANDARD FORMS OF POLICY

Fifth. Standard forms of policy should be prescribed by law. This would go far toward preventing deception. By simplifying and standardizing the contracts, in connection with compulsory annual dividends, the insured would be enabled to compare results in the several companies. To-day such a comparison is practically impossible. The Equitable has outstanding at least 224 different forms of policy; the New York Life 316; the Mutual Life 220. Standardizing policies would also much reduce the work (and hence the expense) of the business.

THE RESTRICTION OF INVESTMENTS

Sixth. The investment of the company's funds should be surrounded by safeguards similar to those adopted in the case of savings banks. This would secure safety. This would also go far in preventing the use of funds in speculative enterprises, or to advance private interests, and greatly limit the possibility of the companies engaging in syndicate operations. Investment should not be made in the securities of corporations in which any executive officer or member of the investment committee of the insurance company is interested.

TREASURY SAFEGUARDS

Seventh. Further to protect the funds of the companies and to prevent their being used directly or indirectly to advance the private or other interests of officers, provision should be made to prohibit the executive officers from engaging in any other business or holding

office in any other business corporations. Treasury safeguards also should be adopted to prevent payments without properly authorized warrants.

ACCOUNTING AND PUBLICITY

Eighth. Methods of accounting should be introduced which would compel the entry of all transactions in a single prescribed set of books, and the submission to the directors at all meetings of reports showing in detail the condition and the operations of the company. In such reports the cost of every department of the business and every kind of business transacted should be clearly determined and disclosed, and likewise the condition, character, and result of each investment. Publicity as to the policy-holders also is essential to insure the proper conduct of the business by officers and directors.

DIRECTORS WHO DIRECT

Ninth. The board of directors must be composed of men who recognize the proper function of life insurance companies, and who, like the trustees of our savings banks, recognize the sacred trust involved in their control; men who are willing to give to the companies the time and attention required for the proper performance of a director's duty; men who having the sole responsibility for the management of the company will not delegate to the executive officers or committees powers which the board alone should exercise.

Such comprehensive and fundamental changes must be made if existing abuses are to be eradicated; but even they will not prove effective to protect the insured and the community unless in addition:

THE SIZE OF THE COMPANY BE LIMITED

Tenth. A limit must be placed upon the size of the company. A company may of course be too small to be a safe or an efficient and economical unit, but it is clearly in the interest of the insured that the company be not allowed to expand beyond the point of greatest efficiency. It is clearly in the interest of the whole people that it be not allowed to expand beyond the point of danger arising from concentration of quick capital in the hands of a few individuals.

The constitutional right to so limit the size of insurance companies is undisputed.

Throughout the early years of our history the danger inherent in corporate control was so well understood that in every State limits were placed upon the amount of the authorized capital of corporations of various kinds. The fear of the power of large banking and industrial combinations was then general. Under influences, not always creditable, and under the leadership of New Jersey, that limit upon the amount of capital of corporations has been in many States removed. Now corporations with huge capital are allowed to exist almost everywhere for almost any purpose. Having created them we try ineffectually to check their operations by anti-trust laws. We have tolerated these monster manufacturing and mining companies and the great railroad corporations mainly because it is believed that somehow, through consolidation, the public may be better served. But whatever may be true in other fields of business it has been proved beyond doubt that in life insurance mere increase in size does not tend to lessen cost of management or to increase returns from investment; that the largest companies are unable to serve the public as well as smaller institutions. It has also been shown conclusively that many of the abuses in the life insurance business, now disclosed, result directly from the size of the companies. Man has not kept pace in growth with his works. Even the executives of the "Big Three" have admitted their inability adequately to supervise their companies. Perkins and other witnesses have sought to excuse illegitimate syndicate transactions and speculative underwritings by the necessities of investing the huge sums pouring into the large companies. On the other hand the investigation has also made clear that these large insurance companies through the power which inheres in the control of quick capital expose the community to dangers which no other kind of corporation presents to so great an extent.

To eradicate abuses—to protect the community—therefore, it is essential that the insuring unit be kept relatively small. You must limit the amount of premiums which it may receive, and the assets which it may hold—as well as the scope and methods of the business.

These in general are the remedies which in my opinion must be adopted to avoid the abuses incident to the life insurance business as now conducted.

THE INEVITABLE ALTERNATIVE

What is the alternative? Not the discontinuance or substantial reduction of life insurance; for life insurance has become a prime necessity. Not the continuance of the present abuses; for the outraged and enlightened public opinion will no longer tolerate them. If our people cannot secure life insurance at a proper cost and through private agencies which deal fairly with them, or if they cannot procure it through private agencies except at the price of erecting financial monsters which dominate the business world and corrupt our political institutions, they will discard the private agency and resort to State insurance.

Despite your or my protest, the extension of Government activity into fields now occupied by private business is urged on every side. Of all services which the commuity requires, there is none in which the State could more easily engage than that of insuring the lives of its citizens. Stripped of the mysteries with which it has been surrounded, and the misleading devices by which it has been permeated, the business of life insurance is one of extraordinary simplicity. To conduct it successfully requires neither energy nor initiative, and if pursued by the State does not even call for the exercise of any high degree of business judgment. The sole requisites would be honesty, accuracy and economy.

The business of life insurance, which the companies now make so incomprehensible to the insured, consists properly only of three elements:

1. The initial medical examination.
2. The calculation of the so-called net premium or insurance and mortality reserve.
3. The investment of funds.

The first is the province of the physician; the second a mere matter of arithmetic worked out by the actuary and now actually performed in large part also by our insurance departments as a necessary incident of their supervision; the third, the proper invest-

ment of funds, would ordinarily require a high degree of judgment. But if the business were conducted by the State, the proper investment of funds would not, at least in Massachusetts, present any difficulty. The State and municipal loans would take up all insurance reserve. The net indebtedness of the Commonwealth on December 31, 1904, was $74,335,130.12, that of our cities and towns $141,658,601. This aggregate of $215,993,731.11, presents a fund far greater than is required as the legal reserve for all the policies now outstanding in this Commonwealth. The net value of all outstanding legal reserve life insurance in Massachusetts on January 1, 1905, was only $122,727,918. The aggregate premiums paid in Massachusetts during the three years ending January 1, 1905, to the thirty-three old line companies was $79,033,991; but the increase during those years of legal reserve requirement was only $23,122,089. The increase of the net State debt and of the gross municipal debt during those years aggregated $34,798,132.74. If the State had done this life insurance business, the three years' increase of legal reserve would not have sufficed to meet the increased borrowings of the State and the municipalities. In Massachusetts at least, a safe investment for our insurance funds would thus be assured.

The net return from such investment of the funds by the State would compare not unfavorably with that now received by the leading insurance companies. It is true that the interest return on Massachusetts State and municipal bonds is less than the present average return of the life insurance companies on investments; but that return in case of State insurance would be net. There would, as to the reserve funds, be no expense of management. Furthermore the investment return of the insurance companies is being almost steadily reduced, and the insurance reserve on new business is being calculated on the basis of 3 1-2 or 3 per cent., which is as low as the average return on State and municipal bonds.

STATE INSURANCE UNDESIRABLE

In my opinion the extension of the functions of the State to life insurance is at the present time highly undesirable. Our Government does not yet grapple successfully with the duties which it has

assumed, and should not extend its operations at least until it does. But whatever and however strong our conviction against the extension of governmental functions may be, we shall inevitably be swept farther toward socialism unless we can curb the excesses of our financial magnates. The talk of the agitator alone does not advance socialism a step; but the formation of great trusts—the huge railroad consolidations—the insurance "racers" with the attendant rapacity or the dishonesty of their potent managers, and their frequent corruption of councils and legislatures is hastening us almost irresistibly into socialistic measures. The great captains of industry and of finance, who profess the greatest horror of the extension of governmental functions, are the chief makers of socialism. Socialistic thinkers smile approvingly at the operations of Morgan, Perkins and Rockefeller, and of the Hydes, McCalls, and McCurdys. They see approaching the glad day when monopoly shall have brought all industry and finance under a single head, so that with the cutting of a single neck, as Nero vainly wished for his Christian subjects, destruction of the enemy may be accomplished. Our great trust-building, trust-abusing capitalists have in their selfish shortsightedness become the makers of socialism, proclaiming by their acts, like the nobles of France, "After us, the Deluge!"

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